

**internal revenue  
memorandum**

TL-N-1764-00  
DABreen

**date:** April 13, 2000

**to:** Rosemary Wallace  
Case Processing Section  
IRS - Philadelphia Customer Service Center  
P. O. Box 245  
Bensalem, PA 19020  
Drop Point 5810

**from:** Kenneth J. Rubin, Assistant District Counsel  
Pennsylvania District Counsel

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**subject:** [REDACTED]  
Barred Assessment and I.R.C. § 6501(e)

This memorandum is in response to an inquiry you made to Senior Attorney David A. Breen. Due to the fact that this response is subject to 10-day post review by National Office, we ask that you not take any action until [REDACTED]. If any changes or modifications are made to our response, you will be notified accordingly.

**ISSUES**

Whether, under the facts presented below: (1) the Service is barred from assessing the tax liability of the taxpayers for tax year [REDACTED] and if so, (2) whether the taxpayers are entitled to a refund of the overpayment.

**CONCLUSION**

The statute of limitations is expired for the assessment of tax for [REDACTED]. However, the taxpayers are not entitled to a refund of the overpayment for that year because no payments were made within two years.

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### FACTS

The taxpayers filed their [REDACTED] Form 1040 on [REDACTED], reflecting a total tax liability of \$[REDACTED]. They remitted \$[REDACTED], with their return (TC 610 posted on [REDACTED]). Form 8621, Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund, was attached to the return. On Form 8621, the taxpayers calculated that they could defer \$[REDACTED] of their \$[REDACTED] total liability, leaving a current tax liability of \$[REDACTED].

On line 54 of Form 1040, "Total Tax", the taxpayers entered \$[REDACTED]. This figure was crossed-out and \$[REDACTED] was written to the right of the crossed-out amount. The notation "Form 8621 ([REDACTED])", was written to the left of the crossed-out figure.

When the return was processed by the Philadelphia Service Center, only \$[REDACTED] was assessed (TC 150 posted on [REDACTED]). The master file account currently reflects a credit balance of \$[REDACTED].

### DISCUSSION

Generally, the Service has three years from the later of the due date of a return or the date filed to make an assessment of income tax. I.R.C. § 6501(a). This three year period is extended to six years if a taxpayer omits from gross income an amount in excess of 25% of the amount of gross income stated on the return. I.R.C. § 6501(e). However, if an omitted amount is stated on the return or disclosed in a statement attached to the return, that amount is not taken into consideration in determining the 25% omission test. I.R.C. §6501(e)(1)(A). The purpose of the extended six year statute of limitations is to give the Commissioner additional time to make an assessment when a return contains nothing which would put the Commissioner on notice that a substantial omission has occurred. Where disclosure is made on the tax return, the need for additional time is obviated by the disclosure.

Congress manifested no broader [scope] than to give the Commissioner an additional two years (later extended to three) to investigate tax returns where, because of a taxpayer's omission to report some taxable item, the Commissioner is at a special disadvantage in detecting errors. In such instances the return on its face provides no clue to the existence of the omitted item."

*Colony Inc. v. Commissioner*, 357 U.S. 18  
(1958)

Gross income is the measuring standard for the two-prong determination of whether the six year statute of limitations applies. The first prong of the test is the determination of omitted gross income; the second prong is the determination of the gross income actually stated in the taxpayer's return.

This is an area where confusion arises from the fact that income tax returns do not directly show gross income. Certain deductions are reported on subsidiary schedules, so that only adjusted gross income, where applicable, and taxable income are shown. Only in the case of a taxpayer whose transactions are relatively straight forward does the "Total income" line on Form 1040, for example, show gross income.

*B.N.A. Tax Management Portfolio*, 501-  
1st, 2 f/n 60.

In the case presented, the taxpayers reported a \$[REDACTED] long-term capital gain from the sale of their stock in [REDACTED], a Luxembourg corporation (selling price of \$[REDACTED] less adjusted basis of \$-[REDACTED]). Therefore, the taxpayers reported all of the gross income from the transaction giving rise to the deferral of tax. There is no evidence to suggest that any other gross income was omitted from the return. In short, there is no omission from gross income on the taxpayer's [REDACTED] tax return. Therefore, the six-year statute of limitations does not apply and the statute of limitations expired on [REDACTED], three years from the date the return was filed. The test as to whether an omitted amount was "stated on the return or disclosed in a statement attached to the return" under I.R.C. §6501(e)(1)(A) is never reached, because there is no omission of income.<sup>1</sup>

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<sup>1</sup> Although the issue of whether an "omitted amount" was "reported on the return" is not reached in our analysis, if it

The error committed by the Service was made by assessing only the non-deferred portion of the tax liability. The assessment should have been \$ [REDACTED], not \$ [REDACTED].

Although the Service erred in not assessing the correct amount of tax, the taxpayer is not entitled to any refund, because any refund is limited to payments made within the last two years under I.R.C. § 6511(b)(2)(B). Since the last payment was made on [REDACTED], and no claim for refund was filed, refund of the overpayment is barred by statute.

If you have any questions, please call Senior Attorney David A. Breen at 215-597-3442.

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cc via E-mail:  
ARC(TL)NER: Corrado

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were an issue, under the facts presented, we would conclude that the amount was reported on the return because the transaction giving rise to the capital gain is reported and the correct tax liability is reflected on the return even though it is crossed-out.